

accounting period in which the change is made and to subsequent periods.

(j)(1) Gains and losses on disposition of tangible capital assets shall be considered as adjustments of depreciation costs previously recognized and shall be assigned to the cost accounting period in which disposition occurs except as provided in subparagraphs (j) (2) and (3) of this subsection. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds in the event of involuntary conversion, and its undepreciated balance. However, the gain to be recognized for contract costing purposes shall be limited to the difference between the original acquisition cost of the asset and its undepreciated balance.

(2) Gains and losses on the disposition of tangible capital assets shall not be recognized where:

(i) Assets are grouped and such gains and losses are processed through the accumulated depreciation account, or

(ii) The asset is given in exchange as part of the purchase price of a similar asset and the gain or loss is included in computing the depreciable cost of the new asset.

Where the disposition results from an involuntary conversion and the asset is replaced by a similar asset, gains and losses may either be recognized in the period of disposition or used to adjust the depreciable cost base of the new asset.

(3) The contracting parties may account for gains and losses arising from mass or extraordinary dispositions in a manner which will result in treatment equitable to all parties.

(4) Gains and losses on disposition of tangible capital assets transferred in other than an arms-length transaction and subsequently disposed of within 12 months from the date of transfer shall be assigned to the transferor.

(5) The provisions of this subsection 9904.409-50(j) do not apply to business combinations. The carrying values of tangible capital assets acquired subsequent to a business combination shall be established in accordance with the provisions of subsection 9904.404-50(d).

(k) Where, in accordance with 9904.409-40(b)(1), the depreciation costs of like tangible capital assets used for

similar purposes are directly charged to cost objectives on the basis of usage, average charging rates based on cost shall be established for the use of such assets. Any variances between total depreciation cost charged to cost objectives and total depreciation cost for the cost accounting period shall be accounted for in accordance with the contractor's established practice for handling such variances.

(1) Practices for determining depreciation methods, estimated service lives and estimated residual values need not be changed for assets acquired prior to compliance with this Standard if otherwise acceptable under applicable procurement regulations. However, if changes are effected such changes must conform to the criteria established in this Standard and may be effected on a prospective basis to cover the undepreciated balance of cost by agreement between the contracting parties pursuant to negotiation under subdivision (a)(4) (ii) or (iii) of the contract clause set out at 9903.201-4(a).

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9904.409-60 Illustrations.

The following examples are illustrative of the provisions of this Standard.

(a) Companies X, Y, and Z purchase identical milling machines to be used for similar purposes.

(1) Company X estimates service life for tangible capital assets on an individual asset basis. Its experience with similar machines is that the average replacement period is 14 years. Under the provisions of the Standard, Company X shall use the estimated service life of 14 years for the milling machine unless it can demonstrate changed circumstances or new circumstances to support a different estimate.

(2) Company Y estimates service life for tangible capital assets by grouping assets of the same general kind and with similar service lives. Accordingly, all machine tools are accounted for as a single group. The average replacement life for machine tools for Company Y is 12 years. In accordance with the provisions of the Standard, Company Y shall use a life of 12 years for

the acquisition unless it can support a different estimate for the entire group.

(3) Company Z estimates service life for tangible capital assets by grouping assets according to use without regard to service lives. Accordingly, all machinery and equipment is accounted for as a single group. The average replacement life for machinery and equipment in Company Z is 10 years. In accordance with the provisions of the Standard, Company Z shall use an estimated service life of ten years for the acquisition unless it can support a different estimate for the entire group.

(b) Company X desires to charge depreciation of the milling machine described in paragraph (a) of this subsection, directly to final cost objectives. Usage of the milling machine can be measured readily based on hours of operation. Company X may charge depreciation cost directly on a unit of time basis provided he uses one depreciation charging rate for all like milling machines in the machine shop and charges depreciation for all such milling machines directly to benefiting cost objectives.

(c) A contractor acquires, and capitalizes as an asset accountability unit, a new lathe. The estimated service life is 10 years for the lathe. He acquires, and capitalizes as an original complement of low-cost equipment related to the lathe, a collection of tool holders, chucks, indexing heads, wrenches, and the like. Although individual items comprising the complement have an average life of 6 years, replacements of these items will be made as needed and, therefore, the expected useful life of the complement is equal to the life of the lathe. An estimated service life of 10 years should be used for the original complement.

(d) A contractor acquires a test facility with an estimated physical life of 10 years, to be used on contracts for a new program. The test facility was acquired for \$5 million. It is expected that the program will be completed in 6 years and the test facility acquired is not expected to be required for other products of the contractor. Although the facility will last 10 years, the contracting parties may agree in advance to depreciate the facility over 6 years.

(e) Contractor acquires a building by donation from its local Government. The building had been purchased new by another company and subsequently acquired by the local Government. Contractor capitalizes the building at its fair value. Under the Standard the depreciable cost of the asset based on that value may be accounted for over its estimated service life and allocated to cost objectives in accordance with contractor's cost allocation practices.

(f) A major item of equipment which was acquired prior to the applicability of this Standard was estimated, at acquisition, to have a service life of 12 years and a residual value of no more than 10 percent of acquisition cost. After 4 years of service, during which time this Standard has become applicable, a change in the production situation results in a well-supported determination to shorten the estimated service life to a total of 7 years. The revised estimated residual value is 15 percent of acquisition cost. The annual depreciation charges based on this particular asset will be appropriately increased to amortize the remaining cost, less the current estimate of residual value, over the remaining 3 years of expected usefulness. This change is not a change of cost accounting practice, but a correction of numeric estimates. The requirement of 9904.409-50(1) for an adjustment pursuant to subdivision (a)(4) (ii) or (iii) of the CAS clause does not apply.

(g) The support required by 9904.409-50(e) can, in all likelihood, be derived by sampling from almost any reasonable fixed asset records. Of course, the more complete the data in the records which are available, the more confidence there can be in determinations of asset service lives. The following descriptions of sampling methods are illustrations of techniques which may be useful even with limited fixed asset records.

(1) A company maintains an inventory of assets in use. The company should select a sampling time period which, preferably, is significantly longer than the anticipated life of the assets for which lives are to be established. Of course, the inventory must be available for each year in the sampling time period. The company would

then select a random sample of items in each year except the most recent year of the time period. Each item in the sample would be compared to the subsequent year's inventory to determine if the asset is still in service; if not, then the asset had been retired in the year from which the sample was drawn. The item is then traced to prior year inventories to determine the year in which acquired.

NOTE: Sufficient items must be drawn in each year to ensure an adequate sample.

(2) A company maintains an inventory of assets in use and also has a record of retirements. In this case the company does not have to compare the sample to subsequent years to determine if disposition has occurred. As in Example (g)(1) of this subsection, the sample items are traced to prior years to determine the year in which acquired.

(3) A company maintains retirement records which show acquisition dates. The company should select a sampling time period which, preferably, is significantly longer than the anticipated life of the assets for which lives are to be estimated. The company would then select a random sample of items retired in each year of the sampling time period and tabulate age at requirement.

(4) A company maintains only a record of acquisitions for each year. The company should select a random sample of items acquired in the most recent complete year and determine from current records or observations whether each item is currently in service. The acquisitions of each prior year should be samples in turn to determine if sample items are currently in service. This sampling should be performed for a time period significantly longer than the anticipated life of assets for which the lives are to be established, but can be discontinued at the point at which sample items no longer appear in current use. From the data obtained, mortality tables can be constructed to determine average asset life.

(5) A company does not maintain accounting records on fully depreciated assets. However, property records are maintained, and such records are retained for 3 years after disposition of

an asset in groups by year of disposition. An analysis of these retirements may be made by selecting the larger dollar items for each category of assets for which lives are to be determined (for example, at least 75 percent of the acquisition values retired each year). The cases cited above are only examples and many other examples could have been used. Also, in any example, a company's individual circumstances must be considered in order to take into account possible biased results because of changes in organizations, products, acquisition policies, economic factors, etc. The results from example (g)(5) of this subsection, for instance, might be substantially distorted if the 3-year period was unusual with respect to dispositions. Therefore, the examples are illustrative only and any sampling performed in compliance with this Standard should take into account all relevant information to ensure that reasonable results are obtained.

9904.409-61 Interpretation. [Reserved]

9904.409-62 Exemption.

This Standard shall not apply where compensation for the use of tangible capital assets is based on use rates or allowances provided by other appropriate Federal acquisition regulations such as those governing:

- (a) Educational institutions,
- (b) State, local, and Federally recognized Indian tribal government, or
- (c) Construction equipment rates (See 48 CFR 31.105(d)).

9904.409-63 Effective date.

(a) This Standard is effective April 15, 1996.

(b) This Standard shall be applied beginning with the contractor's next full cost accounting period beginning after the receipt of a contract or subcontract to which this Standard is applicable.

(c) Contractors with prior CAS-covered contracts with full coverage shall continue to follow Standard 9904.409 in effect prior to April 15, 1996, until this Standard, effective April 15, 1996, becomes applicable after the receipt of a contract or subcontract to which this revised Standard applies.

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